

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Figueroa Analyst: Kristina E. North Bill Number: SB 1452
Related Bills: See Legislative History Telephone: 845-6978 Amended Date: April 26, 2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: State Agency Contracts/Prohibits Contracting With Individual Or Entity That Employs Persons Or Subcontractors Outside the U.S.

SUMMARY

This bill would prohibit the state from contracting for services with a contractor that would employ persons or subcontractors to complete those services outside of the United States.

SUMMARY OF AMENDMENTS

The April 26, 2004, amendment specified that the state would be prohibited from contracting "for services" with specified contractors.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's stated purposed, this bill is to protect the state General Fund's tax revenue and California jobs from the effects of outsourcing jobs.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

The Homeland Security Act of 2002 (P.L. 107-296), as amended, prohibits the U.S. Department of Homeland Security from entering into a contract with a corporate expatriate, as defined. This prohibition may be waived if the Secretary of Homeland Security determines the contract is required in the interest of homeland security.

Under the United States Constitution, Article 1, Section 10, provides that "No State shall...pass any...Law impairing the Obligation of Contracts..." The section is applicable to existing contracts and is not generally considered to impact future contracts.

Board Position:

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Department Director

Date

Gerald H. Goldberg

5/27/04

Current state law prohibits a state agency, absent a compelling public interest, from entering into contracts or agreements with certain publicly traded, foreign (non U.S.) corporations or subsidiaries thereof.

A state agency may contract for various services in accordance with requirements outlined in the Public Contract Code, including the State Contract Act, the State Administrative Manual, and rules of the Department of General Services (DGS).

Current state law requires the DGS to approve a state agency's method of acquisition and procedures followed for procurement. DGS must maintain appropriate criteria and procedures to ensure compliance with the law.

THIS BILL

To the extent it would not conflict with federal law, this bill would prohibit state agencies from contracting for services with certain individuals or entities that employ persons or subcontractors outside the United States to fulfill a state contract.

IMPLEMENTATION CONSIDERATION

Assuming this bill is effective and operative January 1, 2005, the language is silent on whether this bill is intended to apply to contracts awarded before that date. Absent clarifying language, the department would assume existing contracts are valid and would not be set aside. If, however, the bill is to be applicable to all existing state contracts, several significant legal concerns arise. These are discussed below under "Legal Impact."

LEGISLATIVE HISTORY

AB 1829 (Liu, 2003/2004) would prohibit state and local agencies from contracting for services unless the contractor certifies that the work would be performed in the United States. This bill is currently in Assembly Appropriations.

SB 640 (Burton, Stats. 2003, Ch. 633) prohibits state agencies from entering into contracts with expatriate corporations or their subsidiaries unless certain conditions are met.

AB 1121 (Cardoza, 2001/2002) and AB 2375 (Cardoza, 2001/2002) were identical and would have prevented certain foreign corporations from being awarded state contracts for public works, goods, or services. Both bills were held in the Senate Judiciary Committee.

OTHER STATES' INFORMATION

Currently 28 states have introduced legislation regulating or prohibiting state contracts from being outsourced. The legislative websites of *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* were surveyed. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

- ◆ A review of the legislative websites of *Florida* and *Massachusetts* did not reveal any pending legislation outsourcing or expatriate transactions.

- ◆ *Illinois* and *Minnesota* are considering legislation that would require state contractors to certify that their employees are authorized to work in the United States.
- ◆ *Michigan* is considering legislation to address outsourcing. The governor signed an executive directive prohibiting state departments and agencies from spending state or federal funds to provide financial incentives to relocate out of the United States. The state is currently required to extend legal preferences to Michigan-produced goods and services over those of other states and countries.
- ◆ *Minnesota* is considering legislation that would prohibit state contracts to foreign-based call centers.
- ◆ *Minnesota* and *New York* are considering legislation that would require a customer's consent to transfer personal data overseas.
- ◆ *New York* is considering legislation that would disallow any developmental assistance, including tax relief, worker's compensation, and regulatory benefits to entities that relocate positions, jobs, or employment from the State of New York to an outside locality.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue effects of this proposal over the initial three-year period are projected to be as follows:

Fiscal Year Cash Flow Impact Enactment Assumed After 6/30/04 \$ Millions		
2004/2005	2005/2006	2006/2007
*	*	*

* Revenue effect is indeterminate.

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Revenue Discussion

To the extent contractors can acquire waivers to avoid the sourcing restriction, this proposal will have no impact on revenue. If waivers are not issued, the location where some contracted services are performed will change. The revenue impact of these relocations will depend on where the changes occur, whether they involve a change in contractors, and the tax characteristics of all contractors involved. For example, if a contractor moves a call center from India to West Virginia, and wages in West Virginia are higher than in India, the move will both reduce the contractor's profits and decrease its apportionment factors. This would result in a revenue loss. On the other hand, if some services are relocated to California, this could increase

profits and/or wages attributable to California. Revenue effects are even harder to predict if this legislation caused California to select different contractors for some services. If a contract were to be transferred from a previously profitable contractor to a contractor previously reporting net operating losses, there would likely be a revenue loss. If the contract were transferred the other way, there would be a revenue gain. Without identifying the specific contractors involved, the structure of their business operations, and their effective tax rates, it is not possible to know whether this proposal would increase or decrease tax revenues.

LEGAL IMPACT

Article I, Section 10, of the U.S. Constitution provides that "No state shall pass any . . . law impairing the obligation of contracts["]. By its terms, this bill would impact future contracts and could be interpreted to apply to contracts entered into prior to the operative date of the bill, which could be unconstitutional. However, Article 3, Section 3.5, requires every administrative agency to enforce a duly enacted statute until an appellate court has determined the law was unconstitutional.

Article 1, Section 8, of the U.S. Constitution provides that "The Congress shall have Power ... to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes["]. If enacted, this bill could be viewed as unconstitutionally discriminatory because it would prevent foreign corporations from being awarded contracts with the State of California.

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